UPDATE

CLASIS LAW

Preliminary Comments on the proposed amendments in the Insolvency and Bankruptcy Code, 2016

On 17 July, 2019, the Union Cabinet approved some important amendments in the Insolvency and Bankruptcy Code, 2016 (**"Code"**). As stated in the press release[1], the amendments aim to fill critical gaps in the corporate insolvency resolution framework as enshrined in the Code, while simultaneously maximizing value from the Corporate Insolvency Resolution Process (**"CIRP"**).

The changes are expected to lead to timely admission of applications and timely completion of the CIRP, greater clarity on the permissibility of corporate restructuring schemes, manner of distribution of amounts amongst financial and operational creditors, clarity on rights and duties of authorized representatives of voters and applicability of the resolution plan on all statutory authorities.

Basis the proposed changes as outlined in the said press release, our preliminary comments have been set out herein below:

S. No.	Proposed Changes	Preliminary Comments
1	Clarity on allowing comprehensive corporate restructuring schemes such as mergers, demergers, amalgamations etc. as part of the resolution plan.	The measures for implementing the resolution plan as specified in the CIRP Regulations[2] currently include the merger or consolidation of the corporate debtor with one or more persons. There was not enough clarity on whether the comprehensive corporate restructuring of the corporate debtor could be proposed as a part of the resolution plan, though, some resolution plans contemplated the restructuring proposals as one of the measures for the insolvency resolution of the corporate debtor. The proposed change is expected to provide clarity on implementation of comprehensive corporate restructuring of the corporate debtor as a part of the resolution plan and other aspects related thereto.
2	Greater emphasis on the need for time bound disposal at application stage.	In several cases, the applications filed for initiation of CIRP against corporate debtor were pending before the adjudicating authority for unusually long periods. For instance, the insolvency plea filed by the ICICI Bank against Jaiprakash Associates Limited has been pending since September 2018. Finally, the bank had to approach the appellate tribunal which directed the adjudicating authority to decide on the insolvency plea within six (6) weeks. Therefore, the proposed change to emphasise on time bound disposal at application stage is undoubtedly a welcome step.

[1] https://www.ibbi.gov.in/uploads/whatsnew/press_release_of_IBC_Code-1.pdf
[2] The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016

3	A deadline for completion of CIRP within an overall limit of 330 days, including litigation and other judicial processes.	The Code when enacted had envisioned a time bound process for insolvency resolution failing which the corporate debtor would face liquidation. However, in many cases, the CIRP process is yet to complete in spite of the fact that the prescribed timeline of two hundred and seventy (270) days (including extension of ninety (90) days) has already expired. This is on account of the fact that due to endless litigations, the the time spent on legal challenges/litigations was excluded by the appellate tribunal and the adjudicating authority in computing the time period of the CIRP. The proposed timeline of three hundred and thirty (330) days will be inclusive of all litigation and judicial processes. Failure to complete the CIRP within this period would force the corporate debtor to face liquidation. While this change is expected to expedite the CIRP, the proposed timeline should take into account some factors such as motive or intent behind litigation by a party and non-implementation/ withdrawal of resolution plan by the successful resolution applicants etc. This provision, however, faces the risk of misuse by the errant promoters. The defaulting promoters, who are otherwise ineligible to submit a resolution plan for the corporate debtor, may file frivolous/fraudulent litigations to delay the completion of the CIRP within the prescribed timeline and consequently cause the corporate debtor to face liquidation. And once the corporate debtor goes into liquidation, these promoters may try to get back at the helm of the corporate debtor by proposing schemes of arrangements under section 230 of the Companies Act, 2013 since section 29A currently does not apply to proceedings under section 230.
4	Votes of all financial creditors covered under section 21(6A) shall be cast in accordance with the decision approved by the highest voting share (more than 50%) of financial creditors present and voting basis.	The proposed change is likely to be helpful in resolution of real estate developer companies such as Jaypee Infratech Limited. It has been proposed that the votes of all financial creditors being real estate allottees and part of the committee of creditors shall be cast in accordance with the decision of the majority of the real estate allottees present and voting in the meeting.

5	A specific provision that financial creditors who have not voted in favor of the resolution plan and operational creditors shall receive *at least the amount that would have been received by them if the amount to be distributed under the resolution plan had been distributed in accordance with section 53 of the Code* or *the amount that would have been received if the liquidation value of the corporate debtor had been distributed in accordance with section 53 of the Code, whichever is higher*. This will have retrospective effect where the resolution plan has not attained finality or has been appealed against.	The Code currently requires resolution plan to have a provision regarding payment to operational creditors which shall not be less than the amount to be paid to the operational creditors in the event of a liquidation of the corporate debtor under section 53. Also, the CIRP Regulations require that the amount due to the operational creditors under a resolution plan shall be given priority in payment over financial creditors. However, in some cases including Essar Steel case, the adjudicating authority/appellate tribunal treated the operational creditors at par with the financial creditors and directed the resolution applicant to distribute the resolution funds accordingly. Although, the proposed change is expected to settle the debate around the entitlement of operational creditors from the resolution funds offered by the resolution applicant, it is not likely to result into a better recovery for operational creditors given the fact that claims of the operational creditors would always rank below the claims of financial creditors and employees & workmen in the waterfall mechanism prescribed under section 53. As regards the position of the dissenting financial creditors, it is pertinent to note that before 5 October 2018, the CIRP Regulations required that a resolution plan must provide for payment of liquidation value due to the dissenting financial creditors (including abstaining creditors) prior to any recoveries being made by the assenting financial creditors. However, the appellate tribunal, in its order in the Sirpur Paper Mills case, viewed that no discrimination can be made between the financial creditors in the resolution plan on the ground that one has dissented and voted against the resolution plan or the other has supported and voted in favour of the resolution plan. This resulted into an amendment in the CIRP Regulations and consequently, the above-referred provision of the CIRP Regulations was deleted. The proposed change may force the (dissenting) financial creditors, particularly the unsecured financial creditors to vote in favour of resolution plan just for recovering a higher amount since in case such unsecured financial creditors do not vote in favour of the resolution plan, their entitlement would be determined by section 53 of the Code resulting into a larger hair-cut in the recovery of their debt.

6	Inclusion of commercial consideration in the manner of distribution proposed in the resolution plan, within the powers of the Committee of Creditors.	The proposed change is the result of the order passed by the appellate tribunal in the case of Essar Steel wherein the appellate tribunal held that the decision regarding distribution of resolution funds does not fall within the ambit of commercial wisdom of creditors and that committee of creditors, being an interested party, does not have any power to decide on the distribution of resolution funds offered by the resolution applicants. This order of the appellate tribunal stripped the financial creditors of their key powers and triggered a sense of discontentment amongst the lenders. The proposed change to include the commercial consideration in the manner of distribution proposed in the resolution plan, within the powers of the committee of creditors, would definitely increase the confidence of the lenders and investors in the Indian legal system. However, the mechanism/waterfall to be followed practically by the committee of creditors in deciding upon the distribution of resolution funds would be important.
7	Clarity that the plan shall be binding on all stakeholders including the Central Government, any State Government or local authority to whom a debt in respect of the payment of the dues may be owed.	In the case of Synergies Dooray, the appellate tribunal held that all statutory dues including 'Income Tax', 'Value Added Tax' etc. come within the meaning of 'operational debt'. In view of this, the government departments and local authorities are considered as operational creditors under the Code and therefore, the resolution plan approved by the adjudicating authority shall be binding on the government departments and local authorities also besides other stakeholders. Therefore, the proposed change appears to be of clarificatory in nature so as to ensure that the resolution applicant does not face any more challenges from the government departments and local authorities in the implementation of the resolution plan once approved by the adjudicating authority. However, the issue related to the treatment of contingent liabilities, both statutory and contractual, in the resolution plan should also be addressed.
8	Clarity that the Committee of Creditors may take the decision to liquidate the corporate debtor, any time after constitution of the Committee of Creditors and before preparation of Information Memorandum.	The proposed change is likely to address the situations where the corporate debtor does not have any substantial assets and the liquidation of such a corporate debtor may be a better approach rather than wasting time and resources on the insolvency resolution process.